Supreme Court, U. S.
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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-2054

HARRY LEWIS, ALFRED B. REISS, CAROLA GRUEN, as Executrix of the estate of her late husband, Theodore Gruen, IRA BARMARK and COLONIAL SECURITIES CORPORATION,

*Petitioners,*

—v—

HAROLD W. McGRAW, JR., JOHN L. McGRAW, DANIEL F. CROWLEY, PETER O. LAWSON-JOHNSTON, KAY K. MAZUY, WILLIAM J. McGILL, GORDON W. McKINLEY, ALAN J. PIFER, LOUIS PUTZE, HOWARD S. TUTHILL, JAMES E. WEBB, VERNON R. ALDEN, GEORGE R. WEBSTER and McGRAW-HILL, INC.,

*Respondents.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1979

No. .....

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HARRY LEWIS, ALFRED B. REISS, CAROLA GRUEN, as Executrix of the estate of her late husband, Theodore Gruen, IRA BARMARK and COLONIAL SECURITIES CORPORATION,

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—v—

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*Respondents.*

---

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment entered on April 3, 1980, by the United States Court of Appeals for the Second Circuit, which judgment affirmed a judgment of the United States District Court for the Southern District of New York dismissing petitioners' complaint, brought under the Williams Act, Section 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. §78n(e), on the grounds that there was (i) a lack of jurisdiction over the subject matter and (ii) a failure to state a claim for which relief can be granted.

## Opinions Below

The opinion of the United States Court of Appeals for the Second Circuit, filed April 3, 1980, has not yet been officially reported and is set forth in Appendix A hereto.* The opinion of the United States District Court for the Southern District of New York, filed November 30, 1979, has not yet been officially reported and is set forth in Appendix B hereto.**

## Jurisdiction

The judgment of the Court of Appeals was entered on April 3, 1980. No petition for rehearing was filed. This Court's jurisdiction is invoked under 28 U.S.C. Section 1254(1).

## Question Presented

Is the Williams Act violated when persons opposing a tender offer make untrue statements of material facts and omit to state other material facts, and otherwise engage in fraudulent, deceptive and manipulative practices in connection with the tender offer, where the very misconduct alleged deprives the shareholders of the opportunity to accept the tender offer?

## Statute Involved

The Williams Act, Section 14(e) of the Securities Exchange Act of 1934 (15 U.S.C. §78n(e)), provides as follows:

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* The opinion is reprinted at [Current Binder] CCH Fed. Sec. L. Rep. ¶97,344 (2d Cir. 1980).

** The opinion is reprinted at [Current Binder] CCH Fed. Sec. L. Rep. ¶97,195 (S.D.N.Y. 1979).

"It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation."

## Statement of the Case

### A. *The Complaint*

Plaintiffs served a consolidated amended complaint (the "complaint") alleging that the individual defendants, who were directors of defendant McGraw-Hill, Inc. ("McGraw-Hill"), violated the Williams Act when they attacked, with material untruths and omissions, a tender offer by American Express Company ("American Express"). Plaintiffs have brought the case as a class action on behalf of all persons who were McGraw-Hill shareholders on January 31, 1979, the date that McGraw-Hill made its rejection of the American Express offer final.

The essence of the complaint is that defendants violated the Williams Act when they bitterly fought the announced American Express offer with a barrage of material falsehoods and omissions. As set forth in the complaint, although defendants vilified American Express in public (by indicating, among other things, that American Express had illegally complied with the Arab boycott, and that the offer violated the federal Bank Holding Act), defendants omitted to state the most material fact of all: that is, just a few months prior the same McGraw-Hill had

advised the very same American Express that it (McGraw-Hill) was favorably considering a merger with American Express.

Furthermore, although the McGraw-Hill stock was trading on the New York Stock Exchange at approximately $25 per share, McGraw-Hill announced (falsely) that the $40 per share offer by American Express was inadequate. Defendants went on to mischaracterize the American Express offer as "reckless", "illegal", and "improper", descriptions that were as knowingly false as defendants' description of the $40 price as "inadequate". By use of their "scorched earth" policy (as so described by the press), defendants illegally thwarted the American Express tender offer. Upon abandonment of the offer, McGraw-Hill's stock returned to its pre-offer price of $25 per share.

As set forth in the complaint, had defendants told the truth and the whole truth about the American Express proposal, the tender offer would, necessarily, have gone forward at a price of at least $40 per share. Had the truth been told (i.e., defendants knew that American Express was a distinguished company and that $40 per share was a fair price), plaintiffs could have sought injunctive relief and, more importantly, the reasons for accepting the high offer would have been compelling and irresistible. Therefore, the McGraw-Hill shareholders were damaged when defendants were able to defeat American Express's offer to buy all the outstanding shares of McGraw-Hill at $40 per share (representing a 50% premium over the pre-tender offer market price).

**B. *Defendants' Motion***

Defendants moved pursuant to Rules 12(b)(1) and (6) of the Federal Rules of Civil Procedure for an order dis-

missing the complaint for lack of federal jurisdiction over the subject matter and for failure to state a claim for which relief can be granted.

In particular, defendants argued that their conduct had not been "in connection with" a tender offer, hence the Williams Act was inoperative; that under this Court's decision in *Santa Fe Industries* v. *Green,* 430 U.S. 462 (1977), plaintiffs were relegated to the state courts since the action alleged only a breach of fiduciary duty; and that plaintiffs could not have relied on any alleged misconduct because the tender offer was thwarted before the shareholders had an opportunity to accept it.

### C. *The District Court's Decision*

The District Court (per Motley, J.) agreed with plaintiffs that the alleged misstatement and omissions were "in connection with" the American Express offer, and that *Santa Fe Industries* v. *Green, supra,* did not affect plaintiffs' right to bring the case in the federal courts. But the District Court then upheld defendants' argument that since the tender offer had been thwarted, plaintiffs could not have acted in reliance on the alleged misstatements and omissions. Hence the District Court dismissed the complaint for lack of jurisdiction over the subject matter and for failure to state a claim for which relief can be granted.

### D. *The Court of Appeals' Decision*

The Court of Appeals affirmed the District Court's decision in a Per Curiam opinion. The thrust of the opinion is that there could have been no reliance, since the tender offer was frustrated.

The Court of Appeals noted, despite its conclusion, that statements "made on the eve of a tender offer by target or tendering companies" were not "wholly outside the scope

of the Williams Act." Indeed, the Court stressed that such pre-tender offer activity had to be regulated, "[o]therwise, either party would be free to disseminate misinformation up to the effective date of the tender offer, thus defeating in substantial part, the very purpose of the Act—informed decision making by shareholders."

The Court of Appeals decided, in the face of its own language which seems to the contrary, that there was no jurisdiction because the tender offer was, ultimately, abandoned. The Court stated that had the tender offer been continued, then the defendants' statements, alleged in the complaint at bar, would be actionable under the Williams Act.

## Reasons for Granting the Writ

### *The Court of Appeals Has Decided An Important Question Of Federal Law Which Has Not Been, But Should Be, Settled By This Court*

Since the passage of the Williams Act in 1968, hundreds of tender offers (to purchase publicly traded shares) have been made. The purpose of the Williams Act is to ensure that shareholders have the opportunity to evaluate any tender offer and decide for themselves whether or not to accept. At bar, the stock of McGraw-Hill was trading on the New York Stock Exchange at $25 per share, when American Express announced it would pay $40 per share for all of McGraw-Hill's stock that was tendered. The defendants—incumbent management of McGraw-Hill—resisted the American Express announcement with such vehemence and material misstatements that American Express abandoned the offer, and the McGraw-Hill stock returned to its pre-tender offer price of $25 per share.

The very purpose of the Williams Act, however, is to protect shareholders faced with the claims and counter-

claims that are made when a hostile tender offer is announced. *Piper* v. *Chris-Craft Industries,* 430 U.S. 1 (1977); *Electronic Specialty Co.* v. *International Controls Corp.,* 409 F.2d 937 (2d Cir. 1969). At bar, the American Express offer, announced to the public by appropriate press releases and accompanied with the required Schedule 14D-1 filing with the Securities and Exchange Commission, was immediately denounced and vilified by defendants. In *Applied Digital Data Systems* v. *Milgo Electronic Corp.,* 425 F.Supp. 1145 (S.D.N.Y. 1977), the court (per Weinfeld, J.) recognized that the Williams Act would be hollow protection if its coverage did not include all misstatements made to defeat a tender offer. As the *Applied Digital* court held:

> "[To] confine the disclosure and fair-play provisions of the Act to the period after an offer has been formally made, would obviously frustrate the express remedial purposes of the statute. Indeed, it would be anomalous were sections 14(d) and 14(e) not applicable to the offeror or target corporation once a public announcement of an imminent tender or exchange offer was made, for numerous misstatements, omissions and half-truths could be promulgated with relative impunity until the offer was actually filed with and approved by the SEC. Although the shareholders might not in the pre-offer period be faced with a present decision whether to exchange their stock in the target corporation, statements and actions of the target corporation and the offeror during this period clearly have the capacity to affect any future decision and should thus fall within the purview of the statute." *Id.* at 1154.

This Court has not yet decided at what stage of a tender offer the protection of the Williams Act begins. If the decision in *Applied Digital* is correct—that the Act's pro-

tection must begin "once a public announcement of an imminent tender or exchange offer was made"—then this Court should make that protection clear. Until there is a definitive decision by this Court on when, exactly, during a tender offer struggle the protection of the Williams Act is triggered, there will be great confusion and doubt about the effectiveness of that law.

Hostile tender offers have become a permanent part of the business scene. The Court of Appeals, by narrowly restricting the Williams Act, has decided an important question of federal law which should be settled by this Court. For the Court of Appeals' decision withdraws Williams Act protection when it is needed most—from tender offers that are thwarted by material misstatements and manipulative acts. The Court of Appeals' decision will have the harmful and immediate effect of encouraging all sorts of irresponsible resistance to bona fide tender offers.

Williams Act protection affects millions of shareholders. This Court should review a case that imposes unwarranted restrictions on the Act's scope, in direct violation of the stated Congressional purpose.

## CONCLUSION

For the reasons set forth above, Petitioners pray that a writ of certiorari issue to review the judgment of the Court of Appeals for the Second Circuit.

Dated: June 26, 1980

Respectfully submitted,

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# APPENDIX

## Appendix A

**(Opinion of the United States Court of Appeals for the Second Circuit)**

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 953, 1101—September Term, 1979

(Argued March 26, 1980 Decided April 3, 1980)

Docket Nos. 79-7883, 80-7203

HARRY LEWIS, ALFRED B. REISS, CAROLA GRUEN, as Executrix of the estate of her late husband, Theodore Gruen, IRA BARMARK and COLONIAL SECURITIES CORPORATION,

*Plaintiffs-Appellants,*

—v.—

HAROLD W. MCGRAW, JR., JOHN L. MCGRAW, DANIEL F. CROWLEY, PETER O. LAWSON-JOHNSTON, KAY K. MAZUY, WILLIAM J. MCGILL, GORDON W. MCKINLEY, ALAN J. PIFER, LOUIS PUTZE, HOWARD S. TUTHILL, JAMES E. WEBB, VERNON R. ALDEN, GEORGE R. WEBSTER and MCGRAW-HILL, INC.,

*Defendants-Appellees.*

*Appendix A*

Before:

KAUFMAN, *Chief Judge,*
MESKILL, *Circuit Judge,*
and BRIEANT, *District Judge.**

Appeal from a judgment entered in the United States District Court for the Southern District of New York, Constance B. Motley, *District Judge,* dismissing appellant's complaint, brought under the Williams Act, 15 U.S.C. §78n(e) for failure to state a claim under Fed. R. Civ. P. 12.

Affirmed.

STUART D. WECHSLER, New York, New York (Robert I. Harwood, Mordecai Rosenfeld, A. Arnold Gershon, New York, New York, of counsel), *for Plaintiffs-Appellants.*

HERBERT M. WACHTELL, New York, New York (Douglas S. Liebhafsky, Michael W. Schwartz, Theodore N. Mirvis, of counsel), *for Defendants-Appellees.*

* Of the United States District Court for the Southern District of New York, sitting by designation.

*Appendix A*

PER CURIAM:

The instant action is a consolidation of five similar lawsuits brought on behalf of McGraw-Hill, Inc. stockholders, alleging that McGraw-Hill and its directors made false statements of material facts in response to two proposals of the American Express Company for the acquisition of substantial amounts of McGraw-Hill stock. The issue before us is whether shareholders may maintain a cause of action for damages under the Williams Act, 15 U.S.C. § 78n(e),[1] where they concede that no tender offer has been made to them. We conclude that they may not.

I

On January 8, 1979, American Express proposed to McGraw-Hill what plaintiff describes as a "friendly business combination" of the two companies through payment by American Express of $34 in cash for each McGraw-Hill share. Alternatively, American Express indicated its willingness to acquire 49% of McGraw-Hill's shares for cash or a combination of cash and securities. McGraw-Hill common stock was trading at $26 per share immediately prior to the announcement. On January 15, 1979, McGraw-Hill announced that its Board of Directors had rejected the proposal and made

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1 This section provides:

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

public a letter to American Express characterizing the offer as "reckless," "illegal," and "improper." The following day, American Express filed Schedule 14D-1 with the Securities and Exchange Commission concerning its intention to make a cash tender offer for any and all of McGraw-Hill's stock.

The proposed offer was never made, however, for on January 29, American Express retracted its earlier announcement, and in its place submitted a new proposal to the McGraw-Hill board. This offer, at a price of $40 per share, would not become effective unless McGraw-Hill's incumbent management agreed not to oppose it by "propaganda, lobbying, or litigation." The offer was rejected by the McGraw-Hill board two days later, and expired, by its own terms, on March 1.

Plaintiffs' consolidated, amended complaint charges that:

> Defendants announced publicly that the tender offer price of $40 per share was inadequate, although they knew that the price . . . was fair . . . .
>
> Defendants, in resisting the AMEXCO [American Express Company] tender offer [*sic*], challenged the integrity and honesty of AMEXCO (by indicating that AMEXCO had illegally complied with the Arab boycott), publicly challenged the legality of the tender offer (by indicating that the federal Bank Holding Company [Act] may preclude the tender offer), and publicly stated that the tender offer somehow threatened freedom of expression under the First Amendment of the Constitution (by stating that since the McGraw-Hill [*sic*] was engaged in publishing, its indepen-

dence would be smothered by a large financial institution such as AMEXCO).

These statements, as well as McGraw-Hill's characterization of the initial proposal as "reckless," "illegal," and "improper," are alleged to be false, as evidenced by the fact that, some months earlier, McGraw-Hill had advised American Express that it considered it to be a proper and desirable merger partner.

Plaintiffs concede that no tender offer ever took place—that no McGraw-Hill shareholder was ever in a position to offer his shares to American Express at a stated price. The $34 proposal was withdrawn before it became effective, and was replaced with a $40 proposal that could have ripened into an offer only upon the acquiescence of the McGraw-Hill board. Nonetheless, plaintiffs claim, "had defendants provided . . . shareholders and the public with complete and truthful information about AMEXCO and its proposed tender offer (*i.e.* that $40 per share was a fair price, and that AMEXCO was a company with which defendants themselves had wanted to merge), the AMEXCO tender offer would have been consummated." Accordingly, they each seek damages from the company and its directors for the difference between the $40 proposed tender price, and the $25 price to which the stock returned after the expiration of the American Express proposal.

Judge Motley dismissed the consolidated amended complaint pursuant to Fed. R. Civ. P. 12, noting that "plaintiffs fail to allege that McGraw-Hill stockholders, or anyone else for that matter, in fact relied upon the alleged misrepresentations or omissions. While plaintiffs do allege deception on the part of defendants,

plaintiffs do not allege that anyone was deceived or that anyone acted in reliance upon the alleged deception to their detriment." Having found plaintiffs' federal claim critically insufficient, the district court dismissed plaintiffs' pendent state claims for want of jurisdiction.

II

The complaint was properly dismissed. Section 14(e) of the Williams Act, 15 U.S.C. § 78n(e), has as its "sole purpose" the "protection of investors who are confronted with a tender offer." *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 35 (1977). It is designed "to ensure that [investors] will not be required to respond [to a tender offer] without adequate information." *Rondeau v. Mosinee Paper Corp.*, 42 U.S. 49, 58 (1975). Accordingly, one element of a cause of action under § 14e is a showing "that there was misrepresentation upon which the target corporation shareholders *relied*." *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973) (emphasis supplied).[2] In the instant case, the target's

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2 We note that the element of reliance has been held "irrelevant" to a cause of action under Rule 10b-5, where material misstatements can be shown to have caused the issuance of securities which, in turn, resulted in losses to plaintiff purchasers. *Shores v. Sklar* [Current] CCH Fed. Sec. L. Rep. ¶ 97,252 at 96,770 (5th Cir. 1980). In *Shores*, plaintiffs could plausibly claim that if defendants had disclosed the truth concerning the financial condition of the issuer, the bond issue in question would never have been marketed. In the case at bar, by contrast, plaintiffs must contend that but for the alleged misstatements and omissions on the part of defendants, American Express would have proceeded with a hostile tender offer, over the opposition of McGraw-Hill. Such a scenario stretches the principle of causation into the realm of mere speculation, for it depends upon proof of an offer that, for all that appears here, American Express never even contemplated.

shareholders simply could not have relied upon McGraw-Hill's statements, whether true or false, since they were never given an opportunity to tender their shares.

Plaintiffs do not contest this indisputable fact, but rather rest upon cases holding that reliance may sometimes be presumed from a showing of materiality. *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970); *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972). These cases, however, in presuming reliance, did not abolish it as an element of the cause of action. Rather, they held that in cases in which reliance is possible, and even likely, but is unduly burdensome to prove, the resulting doubt would be resolved in favor of the class the statute was designed to protect. *Mills v. Electric Auto-Lite Co.*, *supra*, 396 U.S. at 385. We therefore presume reliance only "where it is logical" to do so. *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, *supra*, 480 F.2d at 375. Here, where no reliance was possible under any imaginable set of facts, such a presumption would be illogical in the extreme.

We note in closing that our holding today does not place statements made on the eve of a tender offer by target or tendering companies wholly outside the scope of the Williams Act. On the contrary, where the offer ultimately becomes effective, and reliance can be demonstrated or presumed, such statements may well be made "in connection with a tender offer" as required by § 14e. Otherwise, either party would be free to disseminate misinformation up to the effective date of the tender offer, thus defeating in substantial part, the very purpose of the Act—informed decisionmaking by shareholders. Injunctive relief, moreover, may be available to restrain or correct misleading statements

made during the period preceding a tender offer where it appears that such an offer is likely, and that reliance upon the statements at issue is probable under the circumstances. *Applied Digital Data Systems, Inc. v. Milgo Electronic Corp.*, 425 F. Supp. 1145, 1154-55 (S.D.N.Y. 1977) (Weinfeld, J.). Finally, we must bear in mind that many of the wrongs alleged in this complaint may be recast as state law claims for breach of the fiduciary duties owed to shareholders by directors. *See Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977). Indeed, we note that several plaintiffs have commenced state court actions arising out of the abortive transactions at issue here. In this case, however, since American Express never made its proposed offer to the shareholders of McGraw-Hill, plaintiffs cannot state a cause of action for alleged misstatements under the Williams Act.

## Appendix B

**(Opinion of the United States District Court for the Southern District of New York)**

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

79 Civ. 0552

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HARRY LEWIS, ALFRED B. REISS, CAROLA GRUEN, as Executrix of the estate of her late husband, Theodore Gruen, IRA BARMAK and COLONIAL SECURITIES CORPORATION,

*Plaintiffs,*

—against—

HAROLD W. McGRAW, JR., JOHN L. McGRAW, DANIEL F. CROWLEY, PETER O. LAWSON-JOHNSTON, KAY K. MAZUY, WILLIAM J. McGILL, GORDON W. McKINLEY, ALAN J. PIFER, LOUIS PUTZE, HOWARD S. TUTHILL, JAMES E. WEBB, VERNON R. ALDEN, GEORGE R. WEBSTER and McGRAW-HILL, INC.,

*Defendants.*

---

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CONSTANCE BAKER MOTLEY, *D. J.*

MEMORANDUM OPINION

Defendants in this action have moved for an order, pursuant to Rules 12(b)(1) and 12(b)(6) of the Federal Rules of Civil Procedure, dismissing the complaint for lack of jurisdiction over the subject matter and/or for failure of the federal claims alleged to state a claim upon which relief can be granted. Defendants also have moved, in the alternative, for an order staying the action pending disposition of parallel state-court actions.

The five named plaintiffs originally commenced separate class actions against the defendants. Following defendants' motion to dismiss each of the five complaints, plaintiffs served and filed a consolidated amended complaint. By stipulation among all parties, defendants' motion to dismiss was deemed addressed to the new complaint.

Plaintiffs, shareholders of defendant McGraw-Hill, Inc. (McGraw-Hill), allege in their consolidated amended complaint that defendants violated Section 14(e) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78n(e), in connection with a proposed tender offer by the American Express Company (AMEXCO) for the common stock of McGraw-Hill. The individual defendants in this action are

directors of McGraw-Hill. The series of events leading to the alleged violation of Section 14(e) began on January 8, 1979, when AMEXCO publicly proposed to McGraw-Hill a friendly business combination on the basis of AMEXCO's acquisition of 49% of McGraw-Hill's outstanding securities at $34 per share. Plaintiffs allege that the price per share initially offered by AMEXCO was a substantial premium over $26, the market price of the common stock prior to the proposed AMEXCO offer. Soon thereafter AMEXCO increased its proposed offer to $40 per share for all of McGraw-Hill's shares. In connection with these proposed offers, AMEXCO filed a Schedule 14D-1 with the Securities and Exchange Commission.

Plaintiffs allege that defendants refused to negotiate with AMEXCO and "embarked on an unlawful, improper and illegal plan, scheme and conspiracy to obstruct, delay and defeat the proposed AMEXCO offer." In particular, plaintiffs allege that defendants made untrue statements of material facts and omitted to state material facts, and engaged in fraudulent and deceptive acts and practices, as follows:

1) Defendants announced that the proposed tender offer price of $40 per share was inadequate, although they allegedly knew that the price was fair. Plaintiffs allege that defendants had no genuine basis for believing that the McGraw-Hill stock was worth more than $40 per share.

2) Plaintiffs allege that defendants challenged the integrity and honesty of AMEXCO, publicly challenged the legality of the proposed tender offer, and publicly stated that the proposed tender offer somehow threatened freedom of expression. Plaintiffs maintain that these statements were false and misleading, especially since defendants omitted to advise its shareholders that McGraw-Hill had

earlier advised AMEXCO that McGraw-Hill considered AMEXCO to be a proper and desirable merger partner.

3) Plaintiffs allege that defendants circulated a letter which McGraw-Hill had sent to AMEXCO, characterizing the proposed merger as "reckless," "illegal," and "improper."

4) Plaintiffs allege that defendants denied the plaintiff class the opportunity to sell their McGraw-Hill stock at a large premium.

Plaintiffs allege that the tender offer would have been consummated had defendants provided its shareholders and the public with complete and truthful information about AMEXCO and its proposed tender offer. Instead, defendants rejected the AMEXCO $40 per share proposed offer on January 31, 1979. Plaintiffs allege that defendants violated their statutory and common law fiduciary duties by thwarting the proposed AMEXCO tender offer improperly and illegally.

*Conduct "In Connection With" A Tender Offer*

Section 14(e) provides:

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

*Appendix B*

The sole purpose of the Williams Act of 1968, which added Section 14(e), "was the protection of investors who are confronted with a tender offer." *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 35 (1977). Thus, "'[t]he purpose of the Williams Act is to insure that public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information.'" *Id.* (quoting *Rondeau* v. *Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975)).

The Supreme Court has repeatedly cautioned that "[t]he starting point in every case involving construction of a statute is the language itself." *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring), *quoted in Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976). The critical phrase in Section 14(e) is "in connection with any tender offer." The issue is whether or not the conduct alleged by plaintiffs to have violate [*sic*] Section 14(e) was "in connection with any tender offer." In the case at hand, it appears indisputable that no tender offer ever existed; all that occurred was a "proposed" tender offer by AMEXCO.

The standards to be applied in determining whether conduct is "in connection with a tender offer" were set forth by this court in *Applied Digital Data Systems, Inc.* v. *Milgo Electronic Corp.*, 425 F. Supp. 1145 (S.D.N.Y. 1977). The court in *Applied Digital* held that when "a public announcement of a proposed offer has been made, the very dangers that the Act was intended to guard against come into play, and the application of sections 14(d) and 14(e) is thus appropriate." *Id.* at 1155 [footnote omitted]. The court explained that "[t]here is no apparent reason why any given action may not be taken 'in connection with' a development reasonably certain to take place in the future

or why a recommendation to reject a proposed tender offer is not also a recommendation to 'reject a tender offer.'" *Id.* at 1153. In a critical passage, the *Applied Digital* court reasoned that:

> [To] confine the disclosure and fair-play provisions of the Act to the period after an offer has been formally made, would obviously frustrate the express remedial purposes of the statute. Indeed, it would be anomalous were sections 14(d) and 14(e) not applicable to the offeror or target corporation once a public announcement of an imminent tender or exchange offer was made, for numerous misstatements, omissions and half-truths could be promulgated with relative impunity until the offer was actually filed with and approved by the SEC. Although the shareholders might not in the pre-offer period be faced with a present decision whether to exchange their stock in the target corporation, statements and actions of the target corporation and offeror during this period clearly have the capacity to affect any future decision and should thus fall within the purview of the statute.

*Id.* at 1154 [footnote omitted].

This court has subsequently indicated that *Applied Digital* allows a Section 14(e) action only where the prospective offeror has made a public announcement of a proposed tender offer and has established a clear and definite intent to make a tender offer. *Reserve Management Corp.* v. *Anchor Daily Income Fund, Inc.*, 459 F. Supp. 597, 608 (S.D.N.Y. 1978). In the case at hand, the facts, as alleged by plaintiffs, suggest that AMEXCO had indeed made a public announcement of its proposed tender offer. More-

over, the facts alleged by plaintiffs appear sufficient to establish a clear and definite intent on the part of AMEXCO to make a tender offer. Plaintiffs have alleged statements and actions by defendants which clearly would have had the capacity to affect any future decision by stockholders in a tender offer. Thus, Section 14(e) should apply to statements and actions made by defendants.

Defendants suggest that the doctrine of *Applied Digital* should be limited to only those cases where injunctive relief is sought in the face of an immediate and threatened tender offer. This court finds this argument unpersuasive; nothing in the *Applied Digital* opinion suggests that its reasoning should be limited to actions for injunctive relief. Moreover, it would be inconsistent with the purpose of Section 14(e) to preclude an action for damages relating to pre-tender offer violations in cases where no tender offer was in fact made. Such a limitation of *Applied Digital* would have the effect of providing a safe harbor for target companies who were successful in their use of misstatements or deception to discourage the making of tender offers.

In summary, the court finds that plaintiffs have alleged conduct "in connection with" a tender offer under Section 14(e).

*Santa Fe Industries, Inc.* v. *Green*

Defendants argue that the consolidated amended complaint alleges only breaches of fiduciary duty, and that the complaint fails to allege actionable deception under the principles of *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462 (1977). In *Santa Fe Industries,* the Supreme Court held that a claim "states a cause of action under any part of the Rule 10b-5 only if the conduct alleged can be fairly

viewed as 'manipulative or deceptive' within the meaning of the statute." *Id.* at 473-74. The principles of *Santa Fe Industries* apply to claims under Section 14(e) as well as Section 10(b). *Marshel* v. *AFW Fabric Corp.*, 441 F. Supp. 299, 300 (S.D.N.Y. 1977); *Altman* v. *Knight*, 431 F. Supp. 309, 313-14 (S.D.N.Y. 1977).

This court has recently recognized, however, that:

> The Court's holding in *Santa Fe Industries* makes a showing of manipulation or deception a requirement in a Rule 10b-5 action, but does not, as defendants seemingly maintain, bar all claims related to breaches of fiduciary duty under state law. As the Second Circuit explained in *Goldberg* v. *Meridor*, 567 F.2d 209, 221 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978), in *Santa Fe Industries* the Supreme Court was "drawing the line so as to require plaintiffs to make claims of nondisclosure or misleading disclosure, not as directing the lower courts to dismiss cases where it was claimed that fiduciaries had failed to disclose their self-dealing or had made a misleading disclosure." . . . Where, as here, breaches of fiduciary duty may also involve manipulation or deception, a plaintiff may advance claims under both Rule 10b-5 and state law.

*Jones* v. *National Distillers and Chemical Corp.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 97,140, at 96,293-94 (S.D.N.Y. Oct. 10, 1979). These principles are equally applicable in the context of a Section 14(e) action.

In the case at hand, plaintiffs allege that defendants made misleading disclosures: 1) by announcing that the proposed tender offer price of $40 per share was inadequate; 2) by circulating a letter characterizing the pro-

posed merger as "reckless," "illegal," and "improper"; and 3) by challenging the integrity and honesty of AMEXCO, as well as the legality of the proposed tender offer. In addition plaintiffs allege that defendants failed to disclose that McGraw-Hill had previously advised AMEXCO that McGraw-Hill considered AMEXCO to be a proper and desirable merger partner. As plaintiffs have clearly made claims of both nondisclosure and misleading disclosure, the principles of *Santa Fe Industries* do not require dismissal of this case. While plaintiffs' claims may involve breaches of fiduciary duty, their claims involve nondisclosure and misleading disclosures as well. Thus, the alleged conduct of defendants can fairly be viewed as manipulative or deceptive within the meaning of Section 14(e).

Defendants cite a number of cases in which breaches of fiduciary duty were held not to be actionable under federal securities law. In particular, defendants refer to cases involving "bootstrap" allegations, that is, where plaintiffs allege failure to disclose an alleged breach of fiduciary duty. For example, in *Browning Debenture Holders' Committee* v. *DASA Corp.*, 560 F.2d 1078, 1084 (2d Cir. 1977), the Second Circuit stated that "violation of any such state-law fiduciary duties, including non-disclosure of conflict of interest or unfairness of a conversion price, will not support a claim of constructive fraud under §14(a)." This court has recently noted, however, that "in *Brown*, as in other cases cited by defendants, the court addressed the situation where there was no deception or material misstatements or omission, and did not require dismissal of an action where plaintiff did allege deception or material misstatement or omission accompanying the alleged breach of fiduciary duty." *Jones* v. *National Distillers and Chemical Corp.*, *supra*, at 96,294. In the case at hand, plaintiff

alleges a number of misstatements and omissions which are not of the "bootstrap" variety merely alleging failure to disclose a breach of fiduciary duty.

Defendants argue that the court's recent decision in *In re Sunshine Mining Co. Securities Litigation,* 77 Civ. 4020 (S.D.N.Y. May 25, 1979), is "virtually 'on all fours'" with the case at hand. In *Sunshine Mining,* the court held that the wrongful withholding of support for a proposed tender offer does not amount to a fraudulent, deceptive, or manipulative act or practice under the principles of *Santa Fe Industries.* The court explained that "[s]ince plaintiff's claim that approval of the tender offer was withheld by management for purely selfish reasons amounts to no more than a charge that Sunshine management acted unfairly and in breach of its fiduciary duties, plaintiff does not state a cause of action under the federal securities laws." Slip op. at 6. In the case at hand, unlike in *Sunshine Mining,* plaintiff alleges misstatements and omissions actionable under Section 14(e). Thus, it is clear that neither *Santa Fe Industries* nor any of the other cases cited by defendants on this point require dismissal of the consolidated amended complaint.

*Causation and Reliance*

It is well-established that in a Section 14(e) action, plaintiffs "must show that there was a misrepresentation upon which the target corporation stockholders relied and that this was in fact the cause of [plaintiffs'] injury." *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.,* 480 F.2d 341, 373 (2d Cir.), *cert. denied,* 414 U.S. 910 (1973). In the case at hand, it would appear that plaintiffs fail to allege that McGraw-Hill stockholders, or anyone else for

that matter, in fact relied upon the alleged misrepresentations or omissions. While plaintiffs do allege deception on the part of defendants, plaintiffs do not allege that anyone was deceived or that anyone acted in reliance upon the alleged deception to their detriment. This court recently stressed the importance of alleging reliance and causation in the Section 10(b) context:

> [B]efore the court can ask "Was the conduct deceptive?", it must first ascertain "To whom?" Since a 10b-5 action requires a causal connection between the defendant's violation and the plaintiff's loss, the allegedly deceived observers will have to be persons who were in a position to make a decision that led to that loss.

*Klamberg* v. *Roth,* 473 F. Supp. 544, 550 (S.D.N.Y. 1979) [footnote omitted].

In the case at hand, plaintiffs, as stockholders, were simply never in a position to make a decision that could lead to any loss. The only attempt to allege reliance or causation in the consolidated amended complaint is its allegation that:

> Had defendants provided its shareholders and the public with complete and truthful information about AMEXCO and its proposed tender offer (i.e., that $40 per share was a fair price; and that AMEXCO was a company with which defendants themselves had wanted to merge), the AMEXCO tender offer would have been consummated.

A similar allegation was held insufficient by this court in *Rediker* v. *Geon Industries, Inc.,* 464 F. Supp. 73 (S.D. N.Y. 1978). In *Rediker,* the plaintiff alleged that the de-

fendant executives of Geon had engaged in fraudulent activities as a result of which Burmah, an intended tendering party, had determined to desist from going forward with the deal. The court held:

> Plaintiff must show that there was a misrepresentation upon which she and other target shareholders relied and that this reliance was in fact the cause of their injury. . . . The facts as alleged herein do not establish that Geon shareholders' reliance on the alleged misrepresentation was the cause of the shareholders' injury. Misdeeds by the defendants may have caused Burmah to abort the deal, and this, in turn, may have caused the market price of Geon to plummet and may have thereby injured plaintiffs. Thus, the alleged injury was caused by the aborting of the deal and not by the shareholders' reliance on defendants' alleged misrepresentations. Plaintiff's remedies, if any, lie in state court for common law claims.

*Id.* at 82 [footnote and citations omitted]. *See also Hundahl* v. *United Benefit Life Insurance Co.*, 465 F. Supp. 1349, 1366-70 (N.D. Tex. 1979); *Halle & Stieglitz, Filor, Bullard Inc.* v. *Empress International, Ltd.*, 442 F. Supp. 217, 225 (D. Del. 1977); *Altman* v. *Knight, supra,* at 314.

Here, as in *Rediker,* plaintiff alleges that defendants have frustrated the consummation of a tender offer. Such a theory will not support a Section 14(e) action. Plaintiffs allege neither reliance on the part of stockholders nor reliance on the part of AMEXCO—in fact, any suggestion that AMEXCO withdrew its proposed tender offer in *reliance* upon the alleged McGraw-Hill misrepresentations and omissions would be absurd. Even assuming that misrepresentations or omissions thwarted the proposed

AMEXCO tender offer, such an allegation would not give rise to a Section 14(e) violation. The situation is not unlike that in *Blue Chip Stamps* v. *Manor Drug Stores, supra,* where the Supreme Court held that fraudulent misrepresentations which prevented a "purchase" of a security from ever taking place did not give rise to a violation of Rule 10b-5.

Of course, this court recognizes that in many circumstances a presumption of reliance and causation may be triggered by a finding of materiality. *See Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 153-54 (1972); *Mills* v. *Electric Auto-Lite Co.,* 396 U.S. 375, 385 (1970); *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.,* 480 F.2d 341, 375 (2d Cir.), *cert. denied,* 414 U.S. 910 (1973). In the case at hand, however, such a presumption would be totally inappropriate. As discussed above, not only have plaintiffs failed to allege reliance on the part of stockholders, but also the facts as alleged by plaintiffs present a situation in which reliance was virtually impossible. As no tender offer was ever actually made by AMEXCO to McGraw-Hill stockholders, these stockholders were never in a position to rely upon the alleged misstatements or omissions by McGraw-Hill. This is not to say that reliance upon pre-tender offer misstatements and omissions is precluded in all cases. This court holds, however, that plaintiffs' consolidated amended complaint must be dismissed for failure to allege reliance and causation in a manner sufficient to sustain its Section 14(e) claim.

*State Claim*

Upon dismissal of plaintiffs' federal claim, their state-law claim of breach of fiduciary duty also must be dismissed for lack of pendant [*sic*] jurisdiction. The Supreme Court

has instructed that "if the federal claims are dismissed before trial, even though not insubstantial in a jurisdictional sense, the state claims should be dismissed as well." *United Mine Workers* v. *Gibbs,* 383 U.S. 715, 726 (1966); *accord, Kavit* v. *A. L. Stamm & Co.,* 491 F.2d 1176, 1179 (2d Cir. 1974). "Pendent jurisdiction can be relied upon only where there is a claim conferring federal jurisdiction that will survive a motion to dismiss." *IIT* v. *Vencap, Ltd.,* 519 F.2d 1001, 1015 (2d Cir. 1975).

*Conclusion*

For the reasons stated above, defendants' motion to dismiss the complaint for lack of jurisdiction over the subject matter and for failure to state a claim for which relief can be granted must be granted. Accordingly, it is not necessary for the court to address defendants' motion for a stay.

Dated: New York, New York
November 30, 1979

So Ordered.

Constance Baker Motley
U.S.D.J.